

NORTH DAKOTA TEACHERS' FUND FOR RETIREMENT

INVESTMENT POLICY STATEMENT

1. PLAN CHARACTERISTICS AND FUND CONSTRAINTS.

The North Dakota Teachers' Fund for Retirement (TFFR) is a pension benefit plan that was established in 1913 to provide retirement income to all public school and certain state teachers and administrators in the state of North Dakota. The plan is administered by a seven member Board of Trustees comprised of five members appointed by the Governor of North Dakota and two elected officials, the State Treasurer and the State Superintendent of Public Instruction.

The plan is a multi-employer defined benefit pension plan that provides retirement benefits, disability retirement benefits, and survivor benefits, as the case may be, in accordance with Chapter 15-39.1 of the North Dakota Century Code (NDCC). Monthly retirement benefits are based on the formula: Number of Years of Service X 2.0% X One-thirty-sixth of the Sum of Three Highest Annual Salaries. Adjustments to the basic formula are made depending on the retirement option selected.

Funding is provided by monthly employee contributions of 7.75% of payroll and matching employer contributions. On an annual basis, benefit payouts exceed contributions. The asset/liability study completed in June 2000 indicates that a 2% cash equivalents allocation is expected to provide sufficient liquidity for the next 10 years.

The TFFR Board has an actuarial valuation performed annually. The current actuarial assumed rate of return on assets is 8.0%. Key plan and financial statistics as of the most recent valuation are recorded in the Asset/Liability Model presented in June 2000 by Watson Wyatt Worldwide and on file at the North Dakota Retirement and Investment Office.

2. RESPONSIBILITIES AND DISCRETION OF THE STATE INVESTMENT BOARD (SIB).

The TFFR Board is charged by law under NDCC 21-10-02.1 with the responsibility of establishing policies on investment goals and asset allocation of the Fund. The SIB is charged with implementing these policies and asset allocation and investing the assets of the Fund in the manner provided in NDCC 21-10-07, the prudent institutional investor rule. The fiduciaries shall exercise the judgment and care, under the circumstances then prevailing, that an institutional investor of ordinary prudence, discretion, and intelligence exercises in the management of large investments entrusted to it, not in regard to speculation but in regard to the permanent disposition of funds, considering probable safety of capital as well as probable income. The Fund must be invested exclusively for the benefit of the members and their beneficiaries in accordance with this investment policy.

The SIB may delegate investment responsibility to professional money managers. Where a money manager has been retained, the SIB's role in determining investment strategy and security selection is supervisory not advisory.

At the discretion of the SIB, the Fund's assets may be pooled with other funds. In pooling funds, the SIB may establish whatever asset class pools it deems necessary with specific quality, diversification, restrictions, and performance objectives appropriate to the prudent investor rule and the objectives of the funds participating in the pools.

The SIB is responsible for establishing criteria, procedures, and making decisions with respect to hiring, keeping, and terminating money managers. SIB investment responsibility also includes selecting performance measurement services, consultants, report formats, and frequency of meetings with managers.

The SIB will implement changes to this policy as promptly as is prudent.

3. INVESTMENT OBJECTIVES.

The investment objectives of the plan have been established by the TFFR board upon consideration of the board's strategic objectives and a comprehensive review of current and projected financial requirements.

Objective #1: Accumulate sufficient wealth through a diversified portfolio of investments and employer and employee contributions to pay all current and future benefit and expense obligations when due.

Objective #2: Build a funding cushion to provide for future benefit improvements by emphasizing higher return/higher risk assets in the fund's asset allocation.

Objective #3: Improve, or at least maintain, the funded ratio without requiring future increases in employee or employer contribution rates.

4. STANDARDS OF INVESTMENT PERFORMANCE.

The plan's investment objectives and characteristics give rise to an asset allocation that is considered to have greater than a 50% probability of achieving the results desired. For evaluation purposes, the following performance targets will apply:

- a. The Fund should produce a rate of return that at least matches that of the policy portfolio, which is comprised of 30% S&P 500 Stock Index, 10% Russell 2000, 20% MSCI EAFE, 5% Emerging Markets (MSCI Emerging Markets Free Index), 5% Post Venture Capital Index, 7% Lehman Aggregate Bond Index, 7% High Yield (Lehman Brothers High Yield Bond Index), 5% Citigroup Non-US Government Bond Index, 2% 90-day T-bills, 9% NCREIF Index.
- b. The annual standard deviation of total returns for the Fund should not exceed that of the policy portfolio.
- c. Over 10 year and longer time periods the Fund should match or exceed the expected 9.29% rate of return assumed in the asset/liability study. Expected risk for the period, measured by standard deviation, is 11.17%.

5. POLICY AND GUIDELINES

The asset allocation of the TFFR fund is established by the TFFR Board, with input from consultants and RIO staff. Asset allocation is based upon the asset/liability study completed by Watson Wyatt Worldwide and Wyatt Investment Consulting in June 2000. That study provided an appraisal of current cash flow projections and estimates of the investment returns likely to be achieved by the various asset classes over the next 20 years.

In recognition of the plan's objectives, projected financial status, and capital market expectations, the following is the asset allocation for the Fund:

Domestic Equities - Large Cap	30%
Domestic Equities - Small Cap	10%
International Equities	20%
Emerging Markets Equities	5%
Venture Capital/Alt. Invsts.	5%
Domestic Fixed Income	7%
High Yield Bonds	7%
International Fixed Income	5%
Cash Equivalents	2%
Real Estate	9%

Rebalancing of the Fund to this target will be done in accordance with the SIB's rebalancing policy, but not less than annually.

While the SIB is responsible for establishing specific quality, diversification, restrictions, and performance objectives for the investment vehicles in which the Fund's assets will be invested, it is understood that:

- a. Futures and options may be used to hedge or replicate underlying index exposure, but not for speculation.
- b. Derivatives use will be monitored to ensure that undue risks are not taken by the money managers.
- c. No transaction shall be made which threatens the tax exempt status of the Fund.
- d. All assets will be held in custody by the SIB's master custodian or such other custodians as are acceptable to the SIB.
- e. No unhedged short sales or speculative margin purchases shall be made.
- f. Social investing is prohibited unless it meets the Exclusive Benefit Rule and it can be substantiated that the investment must provide an equivalent or superior rate of return for a similar investment with a similar time horizon and similar risk.

For the purpose of this document, Social Investing is defined as *"The investment or commitment of public pension fund money for the purpose of obtaining an effect other than a maximized return to the intended beneficiaries."*

- g. Economically targeted investing is prohibited unless the investment meets the Exclusive Benefit Rule.

For the purpose of this document economically targeted investment is defined as an investment designed to produce a competitive rate of return commensurate with risk involved, as well as to create collateral economic

benefits for a targeted geographic area, group of people, or sector of the economy.

Also, for the purpose of this document, the Exclusive Benefit Rule is met if the following four conditions are satisfied:

- (1) The cost does not exceed the fair market value at the time of investment.
- (2) The investment provides the Fund with an equivalent or superior rate of return for a similar investment with a similar time horizon and similar risk.
- (3) Sufficient liquidity is maintained in the Fund to permit distributions in accordance with the terms of the plan.
- (4) The safeguards and diversity that a prudent investor would adhere to are present.

Where investment characteristics, including yield, risk, and liquidity are equivalent, the Board's policy favors investments which will have a positive impact on the economy of North Dakota.

6. EVALUATION AND REVIEW.

Investment management of the Fund will be evaluated against the Fund's investment objectives and investment performance standards. Emphasis will be placed on three and five year results. Evaluation should include an assessment of the continued feasibility of achieving the investment objectives and the appropriateness of the Investment Policy Statement for achieving those objectives.

Performance reports will be provided to the TFFR Board periodically, but not less than annually. Such reports will include asset returns and allocation data as well as information regarding all significant and/or material matters and changes pertaining to the investment of the Fund, including, but not limited to:

- Changes in asset class portfolio structures, tactical approaches and market values;
- All material legal or legislative proceedings affecting the SIB.

All major liability assumptions regarding number of participants, compensation, benefit levels, and actuarial assumptions will be subject to review by the TFFR Board at such frequency as that board deems appropriate. Any material changes will be reported to the SIB in writing.

Asset Assumptions

Expected Return and Volatility Assumptions

	Arithmetic Average Return	Compound Average Return	Standard Deviation
Large Cap Stocks	10.1%	9.0%	16.0%
Mid Cap Stocks	10.5%	9.1%	18.0%
Small Cap Stocks	11.0%	9.1%	21.0%
International Equity	10.1%	8.6%	18.0%
Real Estate (Direct)	7.5%	7.0%	10.0%
Alternative Investments (General)	14.0%	10.2%	30.0%
Emerging Markets	14.0%	9.0%	35.0%
US Fixed Income	7.1%	6.9%	6.1%
International Fixed Income (Hedged)	6.5%	6.4%	4.6%
International Fixed Income (Unhedged)	6.7%	6.1%	11.0%
High Yield Bonds	9.6%	8.9%	12.4%
Cash Equivalents	5.1%	5.0%	2.5%
Inflation	2.5%	2.5%	2.9%